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REVISED BUDGET ESTIMATES FOR THE BIENNIUM 2002-2003

Report of the Advisory Committee on Administrative and Budgetary Questions

I. INTRODUCTION

1. The Advisory Committee on Administrative and Budgetary Questions has considered the report of the Executive Director of the United Nations Office for Project Services on the implementation of the revised budget for 2002, on the revised budget estimates for the biennium 2002-2003 and on the level of the operational reserve (DP/2002/33). The Committee also had before it, as background documentation, a conference room paper on UNOPS revised budget estimates for the year 2002 (DP/2002/CRP.10), a report on the implementation of the recommendations of the Board of Auditors for the biennium 2000-2001 (DP/2002/35), an action plan on savings from projected staff cuts (DP/2002/35/Add.1), an advance copy of the UNOPS contingency plan for 2002-2003 (DP/2002/35/Add.2) and draft terms of reference and timetable for an independent review of UNOPS (DP/2002/36). During its consideration of these matters, the Committee met with the Executive Director of UNOPS and his colleagues, who provided additional information.

2. The Advisory Committee notes that the projection of income and expenditures of UNOPS during the biennium 2002-2003 has taken place under circumstances that have seriously impacted on the working of that Office. The Advisory Committee notes with concern the serious situation facing the management and operation of UNOPS. The Committee was informed that the massive reduction of business from UNDP that started in 1999 continued during the biennium 2000-2001 and the year 2002 (see annex 1 to this report). Income from UNDP decreased from $79.4 million in the biennium 1998-1999 (or some 92 percent of total project income of UNOPS) to $61.5 million in the biennium 2000-2001 (or 82 percent of total project income). However, UNDP remains UNOPS' largest client since the latter's inception in 1994 (see report of the Board of Auditors to the General Assembly on the accounts of UNOPS for the biennium ended 31 December 2001, para. 25 and Annex 2 to this report).

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3. The Advisory Committee was informed that the UNOPS' delivery dropped considerably in 2001 and consequently its income from project delivery. The budget approved for 2001 (Executive Board decision 2001/19) projected a total income of $56.8 million and total administrative expenditures of $55.3 million. Actual income for 2001 amounted however to only $47.2 million or $9.6 million less than the projected income. Administrative expenditures totaled $52.8 million, exceeding total income by $5.6 million. UNOPS covered this shortfall in income through a drawdown on the operational reserve, in accordance with its Financial Regulations, reducing its level to $5 million (DP/2002/CRP.10).

4. The Advisory Committee was also informed that the performance of UNOPS in 2001 was significantly affected, *inter alia*, by the uncertainty about its future status. The review by the Secretary-General on the operations and continuity of UNOPS, requested in March 2001, was completed in January 2002 when the Secretary-General took the decision to maintain UNOPS as a separate and identifiable entity of the United Nations system that is self-financing, as originally intended by Member States. The Committee was provided with the note of the Secretary-General on the matter (DP/2002/CRP.5). The Committee notes that in reaching its decision, the Secretary-General was assisted by the internal review carried out, at his request, by the Office of Internal Oversight Services (OIOS). The Committee recalls that in paragraph 4 of its report DP/2001/29 of 5 September 2001, it indicated that it was incumbent on the Secretary-General to inform Member States expeditiously on the results of the review. The Committee reiterates its request that the Secretary-General make available to Member States the report of OIOS on UNOPS. Furthermore, the Advisory Committee believes that, in supporting the continued work of UNOPS, as a separate and identifiable entity that provides services to organizations of the United Nations system for the management and delivery of programmes and projects, it is incumbent upon the Secretary-General to take steps to ensure the viability and success of UNOPS.

5. The Advisory Committee recalls that it had also expressed its concern that the prolonged deliberations regarding the future status of UNOPS would have negative impact on its operations, resulting in lower levels of acquisition and delivery (DP/2001/29, para. 4). The Committee was informed that during 2001 the uncertainty regarding the existence of UNOPS had led to a decrease in UNOPS' key businesses, including cancellation or delays of approved project budgets funded by UNDP in an amount of $42 million. The Advisory Committee is concerned that, through no fault of UNOPS, it has not been able to recover fully from UNDP the costs of activities carried out in good faith, with a view to performing the tasks specified in the work plans of approved projects which were subsequently delayed, modified, or cancelled. The Committee recalls that, with respect to the termination or postponement of project budgets, it had indicated that this should be managed through consultation of all parties concerned and in such a way as to minimize the financial consequences and their impact on UNOPS (DP/2001/29, para. 3). In this connection, the Committee recommends that the Administrator of UNDP review the issue so as to reimburse UNOPS in an equitable manner for the costs incurred. (See paragraph. 9 below.)

6. The Advisory Committee notes that the Secretary-General decided to maintain the Management Coordination Committee (MCC), chaired by the UNDP Administrator (see DP/2002/CRP. 5, paras. 7 to 15). The Committee has indicated that the relationships of UNOPS with the entities involved in governing, servicing and advising it are complex and that, at times, may hinder the effective communication and reporting systems of UNOPS (DP/1994/57, paras. 3 and 4). In the Committee's opinion, the responsibilities currently assigned to the MCC appear to establish another layer of executive management for UNOPS; as initially endorsed by the Executive Board, the MCC was established to provide overall oversight and guidance to UNOPS, as a self-financing entity. The Committee was informed that actions taken by the MCC in management of UNOPS have resulted, at times, in unnecessary and costly delays. For example, the Committee was informed that, in the last quarter of 2001, it had become clear that expenditure reductions on non-staff related items would not be sufficient to balance the budget. Both the approved budget and the staffing strength of UNOPS were in excess of the income that was being generated. Had the MCC agreed with staff reduction measures in November 2001 rather than in February 2002, the downward adjustment would have been less painful and savings in 2002 could have been larger.

7. With regard to budget for 2002, the Advisory Committee was informed that in June 2002, the Management Coordination Committee (MCC) decided to revise the approved budget of $56.5 million downward to a ceiling of $44 million. The 2002 revised budget is based on business already acquired but excluding new business in the advanced pipeline that would be signed and implemented during the course of the year. The Advisory Committee remains concerned that the Executive Director of UNOPS has not been given the flexibility needed to manage the organization to react to changes in the fluctuations in delivery of the project portfolio and other services. In this connection, the Committee recalls its comments on the role of the MCC made in its report of 7 October 1994 (DP/1994/57, paras. 13 and 14) and reiterates its recommendation made in its report of 18 September 2000 (DP/2000/38, para. 18) on the need to streamline the budget preparation and review process. To this end, the current role of the MCC in setting a budgetary ceiling should be reconsidered with a view to conforming the procedure for the preparation and submission of the UNOPS budget to that followed by the UN Funds and Programmes.

8. The Advisory Committee notes from paragraph 7 of document DP/2002/36 that the scope of the proposed independent review of UNOPS would include a review of the revenue and cost structures of UNOPS, its operating margins on products and services, as well as its business processes and management tools at hand. The Committee notes that the estimated cost of this review amounts to $200,000 and would be completed in 90 days. The Committee welcomes this review, which is in line with its recommendations in paragraphs 2 and 3 of its report DP/2001/29 of 5 September 2001. The Committee stresses that although UNOPS should continue its efforts to be a cost-effective and competitive provider of services to clients within the United Nations system, it should recover in full from its clients the actual costs of executing projects and providing services. The Committee also reiterates its view that UNOPS should continue its efforts to examine the structure of its business with a view to refining the criteria taken into account to evaluate the commitment of clients and UNOPS' own capacity to deliver. To ensure an expeditious completion of the independent review, the Secretary-General should make appropriate arrangements to ensure that its costs are met.

9. The Advisory Committee notes that, in document DP/2002/35/Add.2, an attempt has been made to formulate a contingency plan for UNOPS in response to Executive Board decision 2002/13. The plan includes actions to be taken by the Executive Director in the event that the operational reserve is unable to absorb administrative expenditures incurred against the UNOPS account for the biennium 2002-2003. In the Committee's opinion some of the steps proposed in paragraphs 9 to 14 to increase income and reduce administrative expenditure are already within the purview of management authority of the Executive Director of UNOPS and do not necessarily form part of a contingency plan related to the level operational reserve. Moreover, some of the proposed actions should also be closely examined in the proposed internal review of UNOPS (see paragraph 9 above). These would include, for example, the question of the rights and obligations of UNOPS and its clients pursuant to contractual arrangements for project delivery (see paragraph 5 above).

10. On the question of the future status of UNDP personnel working with UNOPS and respective liabilities of UNDP and UNOPS the Advisory Committee was informed that the prevalence of staff in UNOPS with differences in contractual status hampers UNOPS' ability to be responsive to the self-financing principle. Categories include UNDP permanent staff expected to return to UNDP, UNDP staff with contracts limited to UNOPS, and UNOPS staff. In addition, the personnel arrangements with UNDP of 1994 are no longer valid and UNOPS has agreed with UNDP to revise them in order to fit their current and future anticipated relationship. UNDP and UNOPS have agreed on a cost-sharing formula applicable to UNDP staff that have been serving with UNOPS and need to be separated as a result of abolition of posts. However, UNDP's precarious financial situation has led UNDP to take certain decisions that are not reciprocal to that which is expected from UNOPS.

11. The Advisory Committee has commented in the past on the need to re-examine UNOPS contracts for personnel services in order to have a flexible post management system that would allow UNOPS to expand and contract its capacity in response to changes in demand and project delivery and income. The Committee has also recognized that the demand for UNOPS services is increasingly calling for specialized capacity for the management of multi-disciplinary initiatives and that UNOPS must respond quickly, efficiently and in the most

cost-effective manner (see, for example, DP/2000/38, paras. 14 to 17). The Committee trusts that the internal review of UNOPS will include the re-examination of these personnel issues.

Implementation of the approved budget for 2002

12. In its decision 2002/13, paragraph 6, the Executive Board approved the 2002 administrative budget in the amount of $44 million on the basis of a total income projected at $44.3 million and a project delivery portfolio of $503.2 million. The Committee notes that at the end of July 2002, project delivery had reached $320.4 million, generating income in the amount of $22.5 million. Total income, including service income for loan administration, was $26.9 million and administrative expenditure amounted to $26.4 million at the end of July 2002 (DP/2002/33, paras. 3 to 6).

13. The Advisory Committee was informed that the latest available figures indicate that UNOPS is on track or even slightly ahead on delivery and income; however, staff related costs have increased about 7.5 per cent as compared with the pro-forma costs used in the budget, as a result mainly of currency fluctuations of the dollar *vis-a-vis* the Euro and other currencies. This situation may lead to overspending the approved administrative budget by some $250,000, or one half of one percent of the approved budget, if measures for further cost containment and possible additional income turn out to be insufficient to compensate for this cost escalation in the personnel component of the budget.

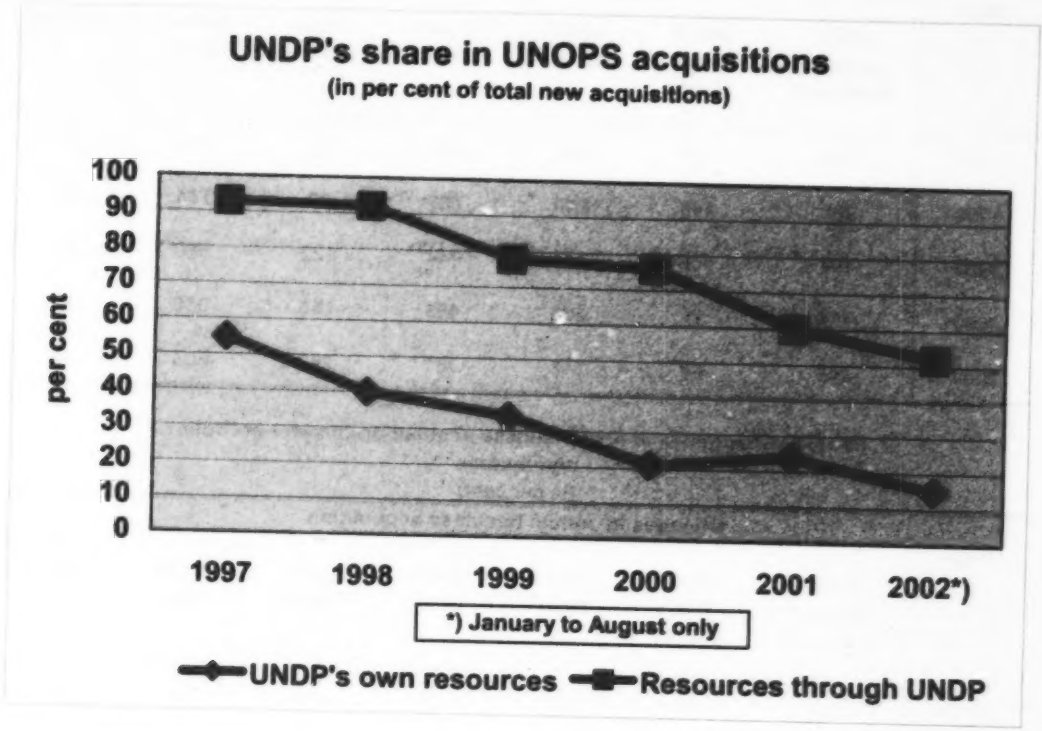
Revised budget estimates for 2003

14. The Advisory Committee was informed that, for 2003, the MCC had initially set a revised target of $41 million, expressed in 2002 dollars (as compared with approved total of $56.5 million.) Given the increases for staff related costs and the need to set aside $1 million for a post-IMIS business information system, the MCC approved a budget ceiling for 2003 at the same level as for 2002 of $44 million. The budget submitted by the Executive Director of UNOPS amounts to $43.9 million and is based on the assumption that the delivery of project portfolio will amount to $513 million, reflecting an increase $9.8 million or 1.9 per cent over the estimate for 2002 of $503.2 million. Total income is projected at $44.7 million, comprising $36.4 million from project delivery, $6.9 million from service income, including services provided to IFAD, and $1.4 million from other income, including income from existing and planned agreements with a number of United Nations organizations for the subletting of office space and the provision of associated services at UNOPS headquarters (DP/2002/33, paras. 12 to 17 and table 1). The Advisory Committee notes from paragraph 16 of document DP/2002/33 that the need to invest in information technology in the amount of $1 million in 2003 is a consequence of the decision by UNDP to implement a new Enterprise Resource Planning (ERP) system, effective 1 January 2004. The Advisory Committee recommends approval of the budget proposal of the Executive Director for 2003.

The level of the operational reserve

15. As indicated in paragraph 3 above, at the end of the biennium 2000-2001, the operational reserve was reduced to $5.0 million. The direct charge to the operational reserve to cover estimated staff separation in 2002 is estimated at $2 million (DP/2002/33, para. 18 and table 1). A total of 44 staff members have been affected by the staff reduction exercise in 2002 (see DP/2002/35/Add.1, para. 8 and table 1). In light of the estimated over-expenditure of $250,000 in 2002 (see paragraph 13 above) and the projected excess of income over expenditure of $800,000 in 2003, the Committee was informed that the operational reserve level would amount to some $3.5 million by the end of 2003. However, in 2003 and 2004 UNOPS medium-term strategy also foresees subletting one fourth of its office space in 2003 and one half from 2004 onwards, allowing the organization to generate additional income, as a result of staff reductions and decentralization measures to move operations to lower cost duty stations.

Annex 1


UNDP's share in UNOPS acquisitions
(in per cent of total new acquisitions)
per cent
100
90
80
70
60
50
40
30
20
10
0
1997
1998
1999
2000
2001
2002*)
*) January to August only
UNDP's own resources
Resources through UNDP

Annex 2

UNOPS: Annual project portfolio acquisition and income
(in millions of dollars)

Year	Project portfolio acquisition						Total income
	UNDP general resources	UNDP Trust Funds	UNDP other*)	Total UNDP	Other clients	Grand total	
1997	391	110	154	655	50	705	41
1998	305	148	249	702	62	764	49
1999	194	106	144	444	122	566	52
2000	136	91	256	483	155	638	49
2001	145	98	118	361	242	603	48

UNOPS: Changes in annual business acquisition (project portfolio) and income
(in per cent)

Year	Changes in annual business acquisition						Total income
	UNDP general resources	UNDP Trust Funds	UNDP other*)	Total UNDP	Other clients	Grand total	
1997	101	7	33	27	194	32	11
1998	-22	35	62	7	24	8	20
1999	-36	-28	-42	-37	97	-26	6
2000	-30	-14	78	9	27	13	-6
2001	7	8	-54	-25	56	-5	-2

*) Since 1997, has included an increasing number of Management Services Agreements negotiated with non-UN funding sources such as International Financial Institutions and governments, where UNDP assumes the function of funds manager and UNOPS is charged with execution.